



Pollution Remediation Obligations Policy

Policy Area: Accounting & Financial Reporting	Effective Date: 7/1/2008
Policy Sub Area: Long Term Liabilities	Last Revision Date: NA
Authority: Codification Section P40	Policy Owner/Division: Statewide Accounting
<p><u>Policy</u></p> <p>State agencies and component units should analyze their pollution remediation obligations at least annually and should recognize pollution remediation liabilities in their financial statements according to the following thresholds:</p> <p><u>Primary Government (e.g., the State)</u> Governmental activities (general long-term debt) – \$1,000,000 Governmental funds – no threshold (<i>based on receipt of goods and services</i>) Proprietary funds – (Total assets less capital assets) multiplied by 0.25%</p> <p><u>Component Units</u> Universities, community colleges, and other component units – (Total assets less capital assets) multiplied by 0.25%</p> <p>Pollution remediation liabilities equal to or in excess of the threshold should be accrued at year-end. Liabilities below the threshold do not need to be accrued at year-end as long-term liabilities (Note: Amounts below the threshold should be recognized as liabilities if the related goods and services have been received).</p>	
<p><u>Procedures</u> NA</p>	

Accounting Guidance

A pollution remediation obligation is an obligation to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities. Pollution remediation activities include the following:

- a) Pre-cleanup activities, such as the performance of a site assessment, site investigation, and corrective measures feasibility study, and the design of a remediation plan;
- b) Cleanup activities, such as neutralization, containment, or removal and disposal of pollutants, and site restoration;
- c) External government oversight and enforcement-related activities, such as work performed by an environmental regulatory authority dealing with the site and chargeable to the government;
- d) Operation and maintenance of the remedy, including required monitoring of the remediation effort (postremediation monitoring).

Not all pollution remediation obligations will involve all of the above activities. For example, asbestos removal typically will not involve postremediation monitoring. Pollution remediation obligations should exclude pollution prevention or control obligations (e.g., obligations to install smokestack scrubbers, treat sewer, or use recycled products).

Pollution remediation outlays should include all direct outlays (e.g., payroll and benefits, equipment and facilities, professional services, etc.) and may include estimated indirect outlays (e.g., general overhead). However, pollution remediation outlays should exclude non-remediation costs, such as fines, penalties, toxic torts, and litigation support involved with specific recoveries.

Obligating Events

GASB Statement 49 identifies five specific "obligating events" that can trigger the recognition of a pollution remediation liability. The five obligating events are as follows:

- a) The government is compelled to take remediation action because pollution creates an imminent endangerment to public health or welfare or the environment, leaving it little or no discretion to avoid remediation action.
- b) The government is in violation of a pollution prevention–related permit or license, such as a Resource Conservation and Recovery Act (RCRA) permit or similar permits under state law.
- c) The government is named, or evidence indicates that it will be named, by a regulator as a responsible party or potentially responsible party (PRP) for remediation, or as a government responsible for sharing costs. *(Note: States can be required to share costs when no financially viable, potentially responsible party can be found for privately owned or operated sites listed as Superfund sites.)*
- d) The government is named, or evidence indicates that it will be named, in a lawsuit to compel the government to participate in remediation. *(Note: If the lawsuit is substantially the same as a previous lawsuit determined to be without merit, the new lawsuit can be excluded from consideration as an obligating event.)*
- e) The government commences, or legally obligates itself to commence, cleanup activities or monitoring or operation and maintenance of the remediation effort. If these activities are voluntarily commenced and none of the other obligating events have occurred relative to the entire site, the amount recognized should be based on the portion of the remediation project that the government has initiated and is legally required to complete.

The occurrence of an obligating event is an absolute precondition for recognizing a pollution remediation liability. That is, if an obligating event has not occurred, then a liability should not be recognized in the financial statements. On the other hand, once an obligating event has occurred, recognition of the related liability is mandatory, assuming that it is considered to be measurable.

Measurement of the Liability

Pollution remediation liabilities should be recognized as the ranges of their components become reasonably estimable. In some cases, the government may have insufficient information to reasonably estimate the ranges of all components of the liability. In these cases, the government should recognize pollution remediation liabilities as the range of each component (e.g., legal services, site investigation, or required postremediation monitoring) becomes reasonably estimable. GASB 49 provides a set of benchmarks to guide the estimation process. In other cases, a government will be able to reasonably estimate a range of all components of its liability early in the process because the site situation is common (e.g., leaking underground storage tanks). In such cases, the entire estimated liability should be recognized at this stage. GASB 49 also requires remeasurement of the liability when new information indicates increases or decreases in estimated outlays (Note: If there are no changes in the remediation plan or operating conditions, the liability can be remeasured by adding an adjustment for inflation).

In the government-wide and proprietary fund financial statements, pollution remediation liabilities should be recorded at the current value, which is the amount that would be paid if all equipment, facilities, and services were acquired during the current period. For the purposes of GASB 49, current value has the following characteristics:

- It is based on reasonable and supportable assumptions about future events that may affect the eventual settlement of the liability.
- It should be based on applicable federal, state, or local laws or regulations that have been approved, regardless of their effective date.
- It should be based on existing technology expected to be used for the cleanup.

The components of the liability should be estimated using the expected cash flow technique, which measures the liability as the sum of probability-weighted amounts in a range of possible estimated amounts—the estimated mean or average. This technique uses all expectations about possible cash flows. Under the expected cash flow technique, the measurement of a government's pollution remediation liability should include all remediation work that the government expects to perform, including work that the government expects to perform for other responsible parties, regardless of whether it is required to do so (Note: As discussed below, expected recoveries from potentially responsible parties or insurance should be included as reductions of expected outlays).

Most pollution remediation outlays, including outlays for capital assets, should be reported as an expense when a liability is recognized. However, GASB 49 identifies four specific situations where all or a portion of pollution remediation outlays should be capitalized rather than expensed (see below).

Capitalization of Pollution Remediation Outlays

Pollution remediation outlays should be capitalized in the government-wide and proprietary fund financial statements when goods and services are acquired for any of the following circumstances:

- a) To prepare property in anticipation of a sale and only if the outlays take place in a reasonable time before the sale. Total capitalized costs should be limited to the estimated fair value of the asset once remediation is completed.
- b) To prepare property for use when that property was acquired with known or suspected pollution that the government expected to remediate. Costs should be capitalized only if the outlays take place within a reasonable time after the purchase. Total capitalized costs should be limited to the outlays expected to be necessary to place the asset into its intended location and condition for use (no fair value cap). When costs run significantly higher than originally anticipated, the costs in excess of the anticipated outlays should generally not be capitalized.
- c) To perform remediation to restore a pollution-caused decline in service utility that the government reported as an impairment of one of its capital assets. The amount thus capitalized

may need to be limited so that the new carrying value does not exceed the fair value of a similar asset.

- d) To acquire property, plant, and equipment that has a future alternative use. In this circumstance, outlays should be capitalized only to the extent of the estimated service utility that will exist after pollution remediation has ceased.

(Note: Remediation outlays that meet the capitalization criteria should be capitalized as incurred; a pollution remediation liability or expense should not be recorded for such amounts.)

Accounting for Recoveries (Government-wide and Proprietary Funds)

Agencies should offset their expense for pollution remediation with anticipated recoveries from other responsible parties and insurers. How this offsetting is achieved depends on whether the recovery is realized/realizable or unrealizable. A realized or realizable recovery involves the acknowledgment or recognition by the third party of its responsibility (i.e., insurance company acknowledges coverage). Without such acknowledgment or recognition, the recovery is considered to be unrealizable. The accounting for recoveries is as follows:

- If the expected recoveries are not yet realized or realizable, they should also reduce the agency's reported pollution remediation liability.
- If the expected recoveries are realized or realizable, they should be recognized separately from the liability as recovery assets (e.g., cash or receivable).
- If recoveries are expected in periods following the completion of all remediation work, the transactions should be reported as revenue and as an asset when they are realized or realizable.

Expected recoveries should be measured in the same manner as pollution remediation outlays (i.e., based on their current value and using the expected cash flow technique). Expected recoveries should exclude grants and other nonexchange transactions (e.g., grants from the State's leaking underground storage tank program or LUST). Expected recoveries, or portions thereof, that are expected to result in capital assets should be reported as capital contributions.

Display in Government-wide and Proprietary Funds

Pollution remediation costs should be reported in the statement of revenues, expenses, and changes in fund net assets as a program or operating expense (or as revenues for recoveries received after all remediation activities have been completed), special item, or extraordinary item.

Display in Governmental Funds

Expenditures and liabilities should be recognized upon receipt of goods and services. Estimated recoveries from insurers and other responsible parties should reduce any associated pollution remediation expenditures when the recoveries are measurable and available.

GASB 49 also requires certain disclosures related to pollution remediation liabilities and recoveries.

Pollution Remediation Examples

Obligations to clean up spills of hazardous wastes or hazardous substances and obligations to remove contamination, such as:

- Leaking underground storage tanks
- Asbestos removal (voluntary commencement or imminent threat)
- Chemical spills
- Water pollution
- EPA Superfund sites
- Brownfield remediation

Illustrations:

Accounting Entries – Enterprise Funds (Accrual Basis)

An obligating event occurs in the current fiscal year indicating that an agency will have to purchase \$100 in goods and services in connection with pollution remediation.

<u>Description</u>	<u>DR (CR)</u>
<u>No Recovery</u>	
Expense.....	\$ 100
Liability	(100)

Realizable Recovery of \$10

Recoveries receivable	\$ 10
Expense	90
Liability	(100)

Unrealizable Recovery of \$10

Expense	\$ 90
Liability (\$100 minus \$10).....	(90)

Note: the following new accounts were added to the statewide chart of accounts for GASB 49:

- 211919 Pollution remediation payable – current
- 221919 Pollution remediation payable – noncurrent

Accounting Entries – Governmental Funds (Modified Accrual Basis)

An obligating event occurs in the current fiscal year indicating that an agency will have to purchase \$100 in goods and services in connection with pollution remediation. The agency received \$25 in goods and services related to pollution remediation during the current fiscal year and then recovered \$5 of that amount within the first 31 days of the following fiscal year. The agency will receive the remaining \$75 in goods and services in subsequent fiscal years.

<u>Description</u>	<u>DR (CR)</u>
Expenditures	\$ 25
Payable.....	(25)
Recoveries receivable	\$ 5
Expenditures.....	(5)

Expected Cash Flow Technique

A university has estimated that its pollution remediation outlays will range from \$80,000 to \$120,000. Either end of this range was considered to be equally likely, although actual outlays were considered 40% likely to be close to \$95,000. The university anticipates that it has a 20% chance of recovering half of its estimated liability. The expected recoveries are not yet realizable. The outlays do not meet the criteria for capitalization. The university would recognize a pollution remediation liability and expense of \$88,200 calculated as follows:

Expected outlays:	
(\$80,000 x 0.3 + \$95,000 x 0.4 + \$120,000	\$
x 0.3)	98,000
Expected recoveries:	
((\$98,000 x 0.5) x 0.2)	
	(9,800)
Pollution remediation liability	\$
	<u>88,200</u>

Related Documents (Memos/Forms)

NA

Revision History

Date	Description